maintenance of a particular credit rating was part of the contract"]; *Water Works Board of the City of Birmingham v Ambac Financial Group, Inc.*, 718 F Supp 2d 1317, 1321 [ND Ala 2010] ["The Board did not bargain for, and did not obtain, a promise that Ambac will maintain a AAA credit rating."]).

As the *Water Works* court observed, as sophisticated commercial parties transacting at an arm's length, insurers and policy holders were free to negotiate for these terms at the time the policies were issued:

> "when the Board bargained for and acquired that benefit, it knew or should have known that Ambac's credit rating could go down during the 35 year life of the Revenue Bonds. If the Board wanted to do so, it could have insisted upon a provision... that if Ambac's rating was ever downgraded, Ambac would have to fulfill the Reserve Fund requirements [mandated by the terms of the Indenture]. Alternatively, the Board could have negotiation for a provision that if Ambac's rating was ever downgraded, the Board could rescind the indemnity agreement and get its premiums back."

(*Water Works* at 1321).

Given that credit ratings are issued by third-party agencies outside of the insurers' control, the *Water Works* court reasonably concluded that such provisions could only be secured at the cost of a much higher premium (*Id.*) which, arguably could have eclipsed any financial benefit gained from the credit enhancement of the bonds.

In this case, it is likewise clear, that the initial bargain between plaintiff and the County did not include an express obligation to maintain any level of credit rating for the life of the Warrants. Furthermore, from the statements in the Official Statements for the Warrant issuances, it is plain the County was aware of this from the moment the policies were issued.

ii. implied duty of good faith and fair dealing

The County' also alleges that plaintiff breached an implied duty of good faith and fair dealing. While the County concedes that plaintiff's credit ratings are set by independent, third-party agencies, it claims that the downgrades in these ratings since 2007 were caused by plaintiff's own negligence in

management of its insured and investment portfolios. These downgrades caused, among others, failure of several auctions of the County's warrants and increases in County's interest rate obligations. Essentially, the County claims that, encompassed in the plaintiff's duty of good faith and fair dealing, was an obligation to conduct its business in a prudent and reasonable manner, including minimizing its exposure to risky investment instruments, so as to lessen the possibility of downgrades by credit rating agencies that would have the consequential effects on the County's obligations under the Warrants.

Plaintiff moves to dismiss the County's breach of implied duty of good faith and fair dealing claim on grounds that plaintiff and the County's relationship is defined by contract, not tort and furthermore, that plaintiff had no duty, statutory or common law, to manage its portfolio holdings for the County's benefit.

"It is a well-established principle that a simple breach of contract is not to be considered a tort unless a legal duty independent of the contract itself has been violated. This legal duty must spring from circumstances extraneous to, and not constituting elements of, the contract, although it may be connected with and dependent upon the contract." (*Clark-Fitzpatrick, Inc. v Long Is. R.R. Co.*, 70 NY2d 382, 389 [1987]). However,

> "New York courts have repeatedly affirmed that a party may be in breach of an implied duty of good faith and fair dealing, even if it is not in breach of its express contractual obligations, when it exercises a contractual right as part of a scheme to realize gains that the contract implicitly denied or to deprive the other party of the fruit of its bargain."

(*Gross v Empire Healthchoice Assur., Inc.*, 16 Misc. 3d 1112A [Sup Ct 2007] [internal citations omitted]).

Finally, as the First Department recently found, a claim for breach of implied duty of good faith and fair dealing may occasionally stand on its own. (*see Maddaloni Jewelers, Inc. v. Rolex Watch U.S.A., Inc.*, 41 AD3d 269, 270 [1st Dept 2007] [finding that where certain contractual terms were to be done at defendant's discretion, "the implied covenant obligated [defendant] to exercise such discretion in good faith, not arbitrarily or irrationally"]).

Despite even the most generous reading of the County's pleadings, this court is unable to find a source of a duty giving rise to a demonstrated want of good faith and fair dealing. In deciding how to manage its insured and investment portfolio after it sold insurance policies to the County, plaintiff was *not* exercising discretion granted to it by the contract between the parties. It was simply continuing to conduct its business for the benefit and under a fiduciary duty to its shareholders.

Just as the County did not bargain for and did not receive an express contractual promise that plaintiff would maintain its credit rating at a particular level, neither did it bargain for and receive an all-encompassing obligation that plaintiff would conduct its business in a manner designed to maximize the financial benefit to the County.

As the court in the *Water Board* case also deduced, these types of insurance policies are issued for the immediate benefit of allowing municipalities to issue highly-rated bonds with low interest rate obligations and then use the capital raised in the bond offering for its intended purposes, instead of being forced to maintain some sort of reserve as required by the terms of the indenture. (*Water Board* at 1321). In other words, the County has already obtained the benefit of its bargain.

Plaintiff's motion to dismiss the County's second counterclaim for express breach of contract is granted for failure to state a cause of action, pursuant to CPLR 3211 (a) (7).

b. The County's fraud/fraudulent omission counterclaim

In its answer, the County brings its third affirmative counterclaim against the plaintiff for fraud and fraudulent omission. Specifically, the County alleges that at the time when plaintiff issued the insurance policies to County, it knew about the risks associated with the portfolio of RMBSs it had insured. (answer ¶ 19 at 28). These risks were material to the County's decision to retain plaintiff as insurer for the Warrants yet were never disclosed. (*Id.* ¶ 20-26 at 28-29).

Plaintiff moves to dismiss these counterclaims both as insufficiently pleaded under CPLR 3016 (b) and for failure to plead a duty to disclose on plaintiff's part.

"The elements of a cause of action for fraud require a material misrepresentation of a fact, knowledge of its falsity, an intent to induce reliance, justifiable reliance by the plaintiff and damages. A claim rooted in fraud must be pleaded

with the requisite particularity under CPLR 3016 (b). (*Eurycleia Partners, LP v Seward & Kissel, LLP*, 12 NY3d 553, 559 [2009]). "Alternatively... a fraud cause of action may be predicated on acts of concealment where the defendant had a duty to disclose material information." (*Kaufman v Cohen*, 307 AD2d 113, 119-120 [1st Dept 2003]).

More specifically, to state a claim for fraudulent inducement in an insurance context, claimants "must allege a misrepresentation or material omission by defendants that induced plaintiffs to purchase the policies, as well as scienter, reliance and injury. (*Gaidon v Guardian Life Ins. Co. of Am.*, 94 NY2d 330, 348 [1999]).

The County pleads that plaintiff had a duty, both at the time the policies were purchased and continuing forward, to disclose to the County risks associated with its investments and insured portfolio. (counterclaims ¶ 22). However, the County has failed to point to a source of law for such a duty.

"Except as required by statute, insurance companies deal with insureds at arm's length. No relationship involving trust or confidence is present." (*Goshen v Mutual Life Ins. Co.*, 1997 NY Misc LEXIS 486, 25-26 [Sup Ct New York County 1997]). "An insurance company does not owe its policyholder a common-law fiduciary duty except when it is called upon to defend its insured." (*Fiala v Metro. Life Ins. Co.*, 6 AD3d 320, 322 (1st Dept 2004] [internal citations omitted]).

New York courts have found that, in certain situations, a confidential relationship giving rise to a special duty may arise between an insurer and potential insureds, such as "when one party places special trust and confidence in another such that the first party becomes dependent upon the second party." (*Goshen* at 28). However, the reported decisions finding the existence of such a relationship are restricted to instances where uninformed prospective individual insureds must rely on insurers to understand complex policy language. (*see Russo v Massachusetts Mutual Life Ins. Co.*, 1997 NY Misc LEXIS 170 [Sup Ct Tompkins Co. 1997]; *Meagher v Metropolitan Life Ins. Co.*, 119 Misc 2d 615 [Sup Ct 1983]). This was certainly not the case here, where all the parties were sophisticated entities, at all times represented by sophisticated counsel.

The County has been unable to point to a single fact or piece of circumstantial evidence that indicates that the plaintiff knew or had reason to know prior to 2004 that its existing exposure to CDOs or RMBSs was risky. Judging by the

all-encompassing nature of the credit crisis which affected the financial industry in 2008, plaintiff was not alone in this ignorance. Without pleading that such facts were in plaintiff's possession, the County cannot establish the "knowledge of falsity" and "intent to induce reliance" elements of its counterclaims.

For the reasons stated above, plaintiff's motion to dismiss the County's third counterclaim for fraud and fraudulent omissions is granted for failure to state a cause of action.

c. The County's negligence counterclaim

The County's negligence claim is premised on very similar factual assertions as its breach of implied duty of good faith and fair dealing and fails for the same reasons.

"In order to establish negligence, plaintiff is required to prove the existence of a duty, that is, a standard of reasonable conduct in relation to the risk of reasonably foreseeable harm (*see Palsgraf v Long Is. R.R. Co.*, 248 NY 339 [1928]); a breach of that duty and that such breach was a substantial cause of the resulting injury." (*Baptiste v New York City Tr. Auth.*, 28 AD3d 385, 386 [1st Dept 2006] [internal citations omitted]).

The County has failed to prove the existence of such a duty. Plaintiff's duty to conduct its business in a reasonable manner was not just a duty it owed to the County. The County repeatedly asks this court to find a common-law duty of an insurer to "preserve solvency and financial security for its policy holders" (Transcript at 27). Such a duty, if it exists, is owed to all of plaintiff's policy and share- holders. However, this duty is heavily regulated by the New York State Department of Insurance as per New York State Insurance Law. The County has failed to point this court in the direction of any provision of these statutes that plaintiff has violated.

For the reasons stated above, plaintiff's motion to dismiss the County's first counterclaim for negligence is granted for failing to state a cause of action.

Conclusion

ORDERED that the motion to dismiss is granted and the counterclaims are dismissed; and it is further

ORDERED that the Clerk is directed to enter judgment accordingly.

Dated: December 21, 2010

DEC 21 2010

ENTER:

James A. Yates, J.S.C.

James A. Yates

Scanned to New York EF on 12-21-10

SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: James A. Yates PART 49

Index Number : 650642/2010

ASSURED GUARANTY MUNICIPAL

VS.

JPMORGAN CHASE BANK, N.A.

SEQUENCE NUMBER : 001

STAY PROCEEDINGS

INDEX NO. _____

MOTION DATE _____

MOTION SEQ. NO. _____

MOTION CAL. NO. _____

this motion to/for _____

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☑ Yes ☐ No

Upon the foregoing papers, it is ordered that this motion is moot pursuant to decision and order dated December 21, 2010. on Motion Seq. No. 002

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Dated: DEC 21 2010

James A. Yates J.S.C.

Check one: ☐ FINAL DISPOSITION ☑ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

☐ SUBMIT ORDER/JUDG. ☐ SETTLE ORDER /JUDG.

SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: James A. Yates Justice PART 49

ASSURED GUARANTY MUNICIPAL

- v -

JP MORGAN CHASE BANK, N.A

INDEX NO. 650642-2010

MOTION DATE

MOTION SEQ. NO. 002

MOTION CAL. NO.

The following papers, numbered 1 to _____ were read on this motion to/for _____

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☒ Yes ☑ No

Upon the foregoing papers, it is ordered that this motion

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING DECISION AND ORDER, DATED 12-21-10

Dated: DEC 21 2010

James A. Yates J.S.C.

Check one: ☐ FINAL DISPOSITION ☑ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

☐ SUBMIT ORDER/ JUDG. ☐ SETTLE ORDER/ JUDG.

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

PRESENT: HON. JAMES A. YATES
SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 49

ASSURED GUARANTY MUNICIPAL CORP., f/k/a FINANCIAL SECURITY ASSURANCE INC., Plaintiff, against JPMORGAN CHASE BANK N.A., and JPMORGAN SECURITIES, INC., Defendants.	Index No. 650642/2010 Decision and Order Motion Seq. No. 002

Quinn Emanuel Urquhart & Sullivan LLP, New York City (*Phillippe Selendy* of counsel), for plaintiff.

Simpson Thacher & Bartlett LLP, New York City (*Mary Beth Forshaw* of counsel), for defendants.

Hon. James A. Yates, J.S.C.

This action arises out of warrants issued by Jefferson County, Alabama ("the County", not a party to the instant action, but a defendant in a related action, *Syncora Guarantee v Jefferson County, Alabama, et al.*, Index No. 601100/2010). The County issued the warrants in order to fund sewer remediation mandated by the Environmental Protection Agency.

The warrants are: the Series 2003-B-8 Sewer Revenue Refunding Warrants, with an original principal amount of $119,965,000, and the Series 2003-C-9 and 2003-C-10 Sewer Revenue Refunding Warrants, with an aggregate original principal amount of $232,025,000 (collectively, "the Warrants"). Also at issue are the Series 2002-C Sewer Revenue Refunding Warrants, with an original principal amount of $839,500,000, for which plaintiff provided bond insurance through a surety bond that provides coverage for all parity warrants issued by the County ("Surety Bond"). The Warrants are limited recourse obligations, which means that the County's contractual obligation to pay principal and interest on them is secured solely by the net revenues

generated by the sewer system.

Many of the warrants issued by the County were variable rate. In order to hedge its risk with respect to the variable interest rate warrants, the County entered into a number of interest rate swap agreements with defendants JPMorgan Chase Bank, N.A. ("JPMorgan Chase") and J.P.Morgan Securities, Inc. ("JP Morgan Securities") (collectively "JPMorgan"). The swap agreements allowed the County to exchange its variable interest rate payment obligations under the Warrants for a fixed rate obligation to be paid to JPMorgan. Plaintiff alleges that these swap agreements were an integral part of the entire financing scheme because they permitted the County to issue variable rate warrants (which are more attractive to investors) while still retaining the ability to pay fixed interest rates on those notes. JPMorgan received fees both for underwriting the Warrants and for acting as the County's counterparty under the swap agreements.

Between 2002 and 2005, defendants and the County solicited plaintiff to insure the County's payment obligations under the Warrants. The insurance was sought in order to improve the bond rating of the issuance, and was expected to make the debt more marketable to investors. Insuring municipal debt was a common and expected practice at the time. Plaintiff's due diligence included examination of the Official Statements for the Warrants and several in-person meetings with Jefferson County officials and representatives of JPMorgan.

Plaintiff alleges that the documents and information included numerous material misrepresentations and omissions. Specifically, they didn't disclose that certain payments to politically connected consulting firms in Alabama were used to pay what plaintiff calls "bribes" to Jefferson County officials in exchange for their vote to select JPMorgan as underwriter and swap counterparty in the Warrants issue and swap transactions.

As a result of this alleged corruption, plaintiff claims, the County's sewer system has been mired in a deep financial crisis. In April 2008, the sewer system failed to generate revenues sufficient to meet the payment obligations due on the Warrants and the County has subsequently defaulted on its payment obligations to the Warrant holders.

Following the County's defaults, plaintiff has been called upon to make a number of payments under the Policies. It has already paid $4 million on the Surety Bond. Plaintiff has additional exposure of more than $370 million remaining on all of the policies issued. Plaintiff brings this action to recover as

rescissionary damages amounts including all of its past and future payment obligations under the Policies, which it does not seek to rescind. Plaintiff commenced this action on June 16, 2010, asserting two causes of action: fraud and aiding and abetting fraud.

Defendants move for an Order dismissing the complaint, pursuant to CPLR 3211 (a) (1), (5), (7) and 3016 (b).

I. **Claims are timely**

Defendants move for an order dismissing the complaint pursuant to CPLR 3211 (a) (5) as untimely.

In New York, the statute of limitations for fraud is the longer of six years from commission of fraud or two years from the discovery of fraud. (*see* CPLR 213 [8]). This action was commenced on June 16, 2010. Plaintiff's claims concern alleged omissions between 2002 and 2003[1]) and thus falls outside the six-year limitation period.

Defendants assert that plaintiff's claims were also brought more than two years from the time information about the fraud became discoverable (defendants' memorandum of law in support of motion to dismiss at 18). In support of its motion, defendants cite several press reports and government investigations that should have put plaintiff on notice of defendants' involvement. (*Id.* at 19).

However, the nature of the articles is not such that it makes it dispositively clear that defendants had any connection to the financial irregularities that County and its officials were being accused of by the SEC nor that they were making payments to politically connected consultancies for no work performed and purely in order to facilitate a corruption scheme, which is the gravamen of the plaintiff's complaint.

The first time that the facts concerning defendants' involvement in the alleged kickback scheme appear to come to light is prior to Larry Langford's trial, in the fall of 2009, just a few months before the filing of the complaint in this action (plaintiff's memorandum of law in opposition of motion to dismiss at 24). As such, this action was timely commenced.

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[1] While one of the Policies was issued in 2005, there is no allegation of solicitation by defendants after 2003.

For reasons stated above, defendant's motion to dismiss plaintiff's complaint as untimely is denied.

II. **Necessary party**

Defendants move for an order dismissing the complaint because plaintiff failed to join the County, which they assert is a necessary party to this action.

Nonjoiner *may* be grounds for dismissal, but it need not be (*see* CPLR 1003: "nonjoinder of a party who should be joined under section 1001 is a grounds for dismissal of an action without prejudice unless the court allows the action to proceed without that party under the provisions of that section."

In *Saratoga County Chamber of Commerce v Pataki* (100 NY2d 801 [2003], *cert denied* 540 US 1017 [2003]) the Court of Appeals cautioned that "[d]ismissal of the action for nonjoinder of a given person is a possibility under the CPLR, but it is only a last resort". (*Id.* at 821, quoting Siegel, NY Prac § 133). In balancing the five factors in CPLR 1001[2], the court finds that they weigh in favor of not dismissing the action, as "an effective judgment may be rendered in absence of the person who is not joined." (CPLR 1001 [b] [5]). To the extent that JPMorgan believes that the County should be joined, it is free to bring third-party claims against the County in this action, pursuant to CPLR 1007.

Defendant's motion to dismiss plaintiff's complaint for failure to join a necessary party is denied.

III. **Fraud claim**

Defendants seek to dismiss plaintiff's first cause of action alleging fraud on the grounds that it fails to state a cause of action.

Under New York law, the elements of a fraud claim are: "(1)

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[2] CPLR 1001 requires the balancing of five factors in order to determine whether to allow the action to proceed without joinder of parties: "1. whether the plaintiff has another effective remedy in case the action is dismissed on account of nonjoinder; 2. the prejudice which may accrue from the nonjoinder to the defendant or to the person not joined; 3. whether and by whom prejudice might have been avoided or may in the future be avoided; 4. the feasibility of a protective provision by order of the court or in the judgment; and 5. whether an effective judgment may be rendered int eh absence of the person who is not joined."

misrepresentation or concealment of material fact; (2) scienter; (3) reasonable reliance; and (4) damages." (*P.T. Bank Cent. Asia, N.Y. Branch v ABN AMRO Bank N.V.*, 301 AD2d 373, 376 [1st Dept 2003)]. "A cause of action for fraudulent concealment requires, in addition to the four foregoing elements, an allegation that the defendant had a duty to disclose material information and it failed to do so." (*Id.*)

Defendants seek to dismiss plaintiff's fraud cause of action on the grounds that defendants never made any affirmative misrepresentation to plaintiff. As such, defendants should only be subject to the fraudulent concealment standard, which plaintiff fails to meet because it cannot make out a duty to disclose between itself and defendants, since they were not parties to the insurance contract between plaintiff and the County.

In addition, defendants argue, plaintiff fails to sufficiently plead the remaining elements of a fraud claim, especially materiality of the information allegedly misrepresented or concealed and scienter.

a. **Materiality**

Defendants argue that plaintiff does not establish the materiality element of the fraud claim because defendants are "not alleged to have had any reason to believe that the alleged swap-related payments were material to Assured." (defendants' memorandum of law in support of motion to dismiss at 10). Moreover, the amounts of third-party payments made in connection with swap transactions were fully disclosed to plaintiff. As such, they did not alter the warrant-related default risk assumed by the plaintiffs.

Initially, plaintiff challenges the assertion that third-party payments were made in connection with swap transactions alone. (*see* complaint ¶¶55, 56 where defendants' employees refer to payments coming out of the fees for both transactions.) Further, there's evidence that the warrant issues and the swap transactions were part of an integrated transaction. Plaintiffs represent that defendants' employees discussed them as such (complaint ¶¶ 21, 26, 33, 42, 55, 56, 59, 69 [c]) and references to the swap transactions were made in the Official Statements for the Warrants provided to plaintiff when defendants and County solicited insurance from it (complaint ¶¶ 69 [b], 70 [b], 71 [b]).

Morever, plaintiff does not challenge that the amounts of

the fees were disclosed to them. The *amount* of the payments is not the basis for this cause of action. Rather, plaintiff contends that it is the *purpose* for which these transfers were made that it finds objectionable. This was not legitimate remuneration to local consulting firms that plaintiff assumed it was when the Policies were issued. Instead, plaintiff contends that these were bribes and as such, were materially relevant to their determination whether or not to insure the offering.

"Information about bribery is relevant to important questions about the competency of management" because "[m]anagement's willingness to engage in practices that probably or obviously are illegal... may be [a] critically important factor[ ]" to parties looking to conduct business with such an enterprise. (*Roeder v Alpha Indus.*, 814 F2d 22, 25 [1st Cir 1987]). Prudent business persons "may prefer to steer away from an enterprise that circumvents fair competitive bidding and opens itself to accusations of misconduct." (*Id.*)

If known, Plaintiff insurer could have reasonably concluded that the County's alleged bribery practices were indicators that the County's affairs were being mismanaged if decisions were made on this illegal basis, rather than through a rational, revenue-maximizing approach.

Defendants' argument that the alleged bribery practices were immaterial, because they represented such a small percentage when compared to the transaction as a whole fails as well. "[M]ateriality of criminal activities is unaffected by the extent of the illegal conduct" because "illegal payments that are so small as to be relatively insignificant to the corporation's bottom line can still have vast economic implications" since "they may endanger all of a corporation's business if they are discovered." (*Galati v Commerce Bancorp, Inc.*, 2005 WL 3797764, 5 [DNJ 2005]).

Here, while the County is not a corporation, its reputation for integrity is still important. Should the County's reputation for credit worthiness have suffered as a result of these allegations, the County may have had difficulty conducting all of its financial affairs, including repayment of existing debt instruments insured by plaintiff.

b. **Scienter**

Defendants argue that plaintiff's cause of action for fraud fails because plaintiff does not allege that defendants acted with an intent to defraud, only that defendants provided

plaintiff with information that may have been false and misleading. (defendants' memorandum in support of the motion to dismiss at 17).

The applicable standard under CPLR 3016 (b) requires that "the misconduct complained of be set forth in sufficient detail to clearly inform a defendant with respect to the incidents complained of and is not to be interpreted so strictly as to prevent an otherwise valid cause of action where it may be impossible to state in detail the circumstances constituting fraud." (*Aris Multi-Strategy Offshore Fund, Ltd. v Devaney*, 26 Misc 3d 1221(A) [Sup Ct New York County 2009]).

In support of a more stringent standard, defendants cite to several federal cases. However, the federal standard is inapplicable here: "[u]nlike the Second Circuit test which requires a 'strong inference' of fraudulent behavior, all that is required under CPLR 3016 (b) is that the facts alleged 'permit a reasonable inference of' fraud. Moreover, because the element of scienter is most likely to be within the sole knowledge of the defendant and least amenable to direct proof, the requirement of CPLR 3016 (b) should not be interpreted strictly when analyzing scienter allegations in a complaint." (*Id.*)

Here, the plaintiffs "need only allege specific facts from which it is possible to infer defendant's knowledge of the falsity of its statements." (*Houbigant, Inc. v Deloitte & Touche*, 303 AD2d 92, 99 [1st Dept 2003]). "It is sufficient if plaintiffs allege, by specific, supported factual allegations, that the statements were materially inaccurate and that [defendant] knew it. These allegations may be disputed by contrary evidence at trial, but their weight should not be addressed here." (*Id.* at 100). The facts need to be sufficient so that "it may be inferred that the defendant was aware that its misrepresentations would be reasonably relied upon by the plaintiff, not that the defendant intended to induce the particular acts of detrimental reliance ultimately undertaken by the plaintiff." (*Id.*)

New York courts have found the following allegations sufficient to sustain the scienter element of a cause of action sounding in fraud: knowing provision of false performance data (*see Aris*) and failure to acknowledge irregularities in financial statements (*see Houbigant*). Even under the more stringent federal standard, a "statement concerning income projections made with knowledge of import restrictions that could undercut those projects [was] sufficient to allege scienter." (*Cosmas v Hassett*, 886 F2d 8, 13 [2d Cir 1989] [as described in *Aris*]).

Here plaintiff provided allegations containing sufficient specificity to make out a claim that defendants' statements were knowingly false. Complaint contains allegations that defendants' employees discussed the alleged illegal payments with County officials and amongst themselves, but failed to disclose the nature of those payments to the plaintiff. (complaint ¶¶ 29, 32, 47, 51-56). Furthermore, plaintiff pleads that defendants "directly benefitted from [their] fraudulent conduct because Assured's agreement to insure the County's interest and principal payments made the Warrants more marketable to investors. This permitted JPMorgan to receive its substantial underwriting and swap fees." (complaint ¶ 96).

c. **Duty to disclose**

Defendants argue that the parties had no fiduciary, confidential or other relationship that would give rise to a duty of disclosure upon which a cause of action for fraudulent concealment could be based because defendants are not parties to the insurance policies.[3] To the extent that defendants made statements concerning the warrants, they were not rendered misleading by a failure to disclose payments made at the County's discretion in connection with the swap transactions.

Plaintiff relies on several alternate sources of law to establish that defendants had a duty to disclose the alleged illegal nature of the third party payments to Alabama consultants. Plaintiff argues that defendants owed plaintiff a duty to disclose under (i) federal securities law, (ii) New York State Insurance Law, and (iii) common law "special facts" doctrine.

Assured bases its initial argument for an existing duty to disclose on federal securities law. It argues that if "federal securities laws require disclosure of illegal payments in connection with securities offerings" (plaintiff's memorandum in opposition of motion to dismiss at 16) for the benefit of investors, these disclosure duties extend to anyone who relies upon the truth of these statements in a different context as well. While the court can see the logic of the plaintiff's argument, it refuses to expand the scope of the federal securities laws on so barren a record.

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[3] JPMorgan Chase, JP Morgan Securities and plaintiff each had contractual relationships with the County, but not with each other.

With regard to New York State insurance law, plaintiff argues that Insurance Law § 3105 imposes upon applicant for insurance, or anyone acting "by the authority of" such a person, "an affirmative statutory duty... to disclose all information known to it that would be material to the insurer's decision whether to issue the policy." (plaintiff's memorandum in opposition of motion to dismiss at 18) (*see e.g. Lighton v Madison-Onondaga Mut. Fire Ins. Co.*, 106 AD2d 892, 893 [4th Dept 1984] ["If the applicant for insurance is aware of the existence of circumstances which he knows would influence the insurer in acting on the application, he is required to disclose that circumstance to the insurer, though unasked."]). Plaintiff argues that by assisting in preparation of the Official Statements for the Warrants and making statements during meetings, defendants were acting, at least "by authority of" the applicant for insurance, the County.

Defendants seek to dismiss this argument as a matter of law, arguing that as a stranger to the insurance policy, they cannot be considered an applicant for insurance. However, genuine issues of material fact exist as to whether defendants can be deemed to have acted "by the authority of" the County, both in putting together the Official Statements used by the County to solicit insurance, and in assisting with County's presentations to the plaintiff during the time when insurance was being sought. As a result, defendants are not entitled to dismissal of this portion of the complaint on these grounds.

Finally, plaintiff argues that outside the sources of statutory law it cites above, defendant owed it a duty of disclosure under the common law "special facts" doctrine. "Under the 'special facts' doctrine, a duty to disclose arises where one party's superior knowledge of essential facts renders a transaction without disclosure inherently unfair." (*Swersky v Dreyer & Traub*, 219 AD2d 321, 327-328 [1st Dept 1996] [internal citations and quotation marks omitted]). Moreover, a party need not be a party to the transaction for the "special facts" doctrine to apply: "a duty to disclose... is not limited to parties in privity of contract when nondisclosure would lead the person to whom it was or should have been made to forego action that might otherwise have been taken for the protection of that person." (*Strasser v Prudential Sec.*, 218 AD2d 526, 527 [1st Dept 1995] [internal citations and quotation marks omitted]).

In determining whether plaintiff has stated facts sufficient to withstand defendants' motion to dismiss pursuant to CPLR 3211 (a) (7) in the instant action, the court bears in mind the rule that "[p]leadings shall be liberally construed. Defects shall be

ignored if a substantial right of a party is not prejudiced." (CPLR 3026). When determining a motion to dismiss, the court must "accept the facts as alleged in the complaint as true, accord plaintiffs the benefit of every possible favorable inference, and determine only whether the facts as alleged fit within any cognizable legal theory" (*Arnav Indus. Inc. Retirement Trust v Brown, Raysman, Millstein, Felder & Steiner*, 96 NY2d 300, 303 [2001]. "So liberal is the standard under these provisions that the test is simply whether the proponent of the pleading has a cause of action, not even whether he has stated one" (*Wiener v Lazard Freres & Co.*, 241 AD2d 114, 120 [1st Dept 1998] [internal quotation marks omitted]).

The elements of a fraudulent concealment claim based on the Special Facts doctrine are all sufficiently plead. Defendants' motion to dismiss the first cause of action for fraud is denied.

IV. **Aiding and abetting fraud claim.**

Plaintiff alleges that defendant aided and abetted the County's fraud by "drafting and distributing to Assured offering and other promotional materials for the Warrants that contained the false representations, and which concealed the bribes that JPMorgan paid to County Commissioners" (complaint ¶ 109).

"A plaintiff alleging an aiding-and-abetting fraud claim must allege the existence of the underlying fraud, actual knowledge, and substantial assistance." (*Oster v Kirschner*, 7 AD3d 51, 55 [1st Dept 2010]).

Defendants argue that plaintiff fails to make out an aiding and abetting claim because the defendants did not have actual knowledge of the payments made to County commissioners nor that they substantially assisted in the fraud.

a. Actual knowledge

In New York, "actual knowledge need only be pleaded generally". (*Oster v Kirschner* at 55). "The language of CPLR 3016 (b) merely requires that a claim of fraud be pleaded in sufficient detail to give adequate notice . . . it should be sufficient that the complaint contains some rational basis for inferring that the alleged misrepresentation was knowingly made. .. Accordingly, plaintiffs here... need only allege specific facts from which it is possible to infer defendant's knowledge of the falsity of its statements." (*Id.* at 57-58).

Plaintiff does plead that defendants knew about the nature

and destination of the payments they were making. In the complaint, plaintiff quotes from conversations between defendants' employees, discussing the payments. For example, it quotes from a conversation in which defendants' employee LeCroy told an associate at the firm : "At some point, we'll have to figure out who we have to pay off. I think instead of Goldman we'll have, we'll probably have someone like Bill Blount." (complaint ¶ 54). In a taped telephone conversation, LeCroy stated: "I got to get the politics lined up. And, of course, we have to pick the partners who are going to get free money from us this time." (complaint ¶ 53).

Plaintiffs have alleged sufficiently specific facts (dates, persons involved, exact statements) from which it seems reasonable to infer that defendants knew that the payments they were making to various Alabama consultancies were not payments for services and would be directed to County commissioners. Therefore, plaintiffs, at this stage, have adequately satisfied the pleading requirements for actual knowledge.

b. Substantial assistance

Under New York law, "[s]ubstantial assistance exists where (1) a defendant affirmatively assists, helps conceal, or by virtue of failing to act when required to do so enables the fraud to proceed, and (2) the actions of the aider/abettor proximately caused the harm on which the primary liability is predicated." (*Stanfield Offshore Leveraged Assets, Ltd. v Metropolitan Life Ins. Co.*, 64 AD3d 472, 476 [1st Dept 2009] [internal quotation marks and citations omitted]).

Defendants argue that at the most, in their interactions with the plaintiff, they failed to act, and therefore plaintiffs must plead that they were "required to do so". They argue that allegations as pled in the complaint are insufficient to support a claim of aiding and abetting fraud absent a fiduciary duty owed by defendants to the plaintiff.

Setting aside for a moment that plaintiff denies that defendants are liable for omissions alone, and points to statements that it alleges constitute affirmative misrepresentations, the Court of Appeals has held that "[a]scertaining the existence of... a [fiduciary] relationship inevitably requires a fact-specific inquiry. " (*Eurycleia Partners, LP v Seward & Kissel, LLP*, 12 NY3d 553, 561 [2009]). Therefore, even if plaintiff is to be held to this heightened standard, it can go forward with discovery in order to establish this claim.

Moreover, "[i]n the context of aiding and abetting, where the primary violations consist of either misrepresentations in, or omissions from, a document, the substantial assistance must relate to the preparation or dissemination of the document itself." (*Morin v Trupin*, 711 FSupp 97, 113 [SD NY 1989]). That is exactly what the plaintiff alleges: that defendants assisted the County in authoring the Official Statement for the Warrants which were then disseminated to the plaintiff (complaint ¶¶ 3, 4, 24, 25, 62-71, 89, 101).

Plaintiffs have presented several legal theories on which to predicate the existence of a fiduciary relationship. However, an important element in deciding which of them applies will be the factual determination of how much assistance defendants provided to the County in preparing the Official Statements for the Warrants and the extent to which they acted by the authority of the County in meetings with the plaintiff insurer. This determination will need to be made after completion of discovery. At this stage in the proceedings, plaintiff has adequately alleged the element of substantial assistance.

For the reasons stated above, at this prediscovery phase plaintiff has alleged its fraud-based claims with the particularity required by CPLR 3016 (b). Therefore, defendants' motion to dismiss the complaint is denied.

Conclusion

ORDERED that defendants' motion to dismiss is denied; and it is further

ORDERED that defendants are directed to serve an answer to the complaint within 10 days after service of a copy of this order with notice of entry.

Dated: December 21, 2010

DEC 21 2010

ENTER:

James A. Yates, J.S.C.

James A. Yates